

1
2
3
4
5
6
7
8
9

10 UNITED STATES BANKRUPTCY COURT
11 DISTRICT OF OREGON

12
13 In Re:) Bankruptcy Case
14 C & K Market, Inc.,) No. 13-64561-fra11
15 Debtor.)) MEMORANDUM OPINION

16 FACTS

17 Prior to its petition for relief, the Debtor in Possession (DIP) owned and operated approximately sixty
18 grocery stores and pharmacies in Southern Oregon and Northern California. It has an operating line of credit
19 with US Bank (“Bank”) and, at the time of the petition, was indebted to the Bank for \$33,809,109. In
20 addition, the DIP was indebted to mezzanine lenders¹ Endeavour Structured Equity and THL Credit, for a
21 combined total of \$30,600,798.

22 Anticipating the need for reorganization, the Debtor began in the summer of 2013 what became
23 “arduous” negotiations with the Bank for a financing package (“DIP facility”) to be put in place when the

24
25 ¹ Generally, a mezzanine lender holds a note convertible to shares or other form of equity in the
26 maker. In this case, the mezzanine lenders were entitled to redeem the notes for Class B
Common Stock of the Debtor.

1 Debtor filed for reorganization under Chapter 11. By autumn, the Debtor determined that it needed to
2 develop an alternative source of post-petition financing, and approached several other lenders. The only
3 lender which appeared willing to respond quickly enough to be of use was Sunstone Business Finance, LLC.
4 The DIP's chief restructuring officer (CRO), Edward Hostmann, asserted that development of an additional
5 source for DIP financing was necessary for two reasons: (1) the DIP wanted an alternative lender in order to
6 gain leverage in its negotiations with the Bank, and (2) prudence dictated that the Debtor have a source of
7 funds to operate post-petition in the event it was forced to file for relief without an agreement with the Bank
8 in place.

9 A proposed lending facility was quickly agreed to, and the Debtor and Sunstone signed a Term Sheet
10 on October 25, 2013. Agreed terms included:

- 11 1. A DIP facility of \$5 to 7.5 million, subject to bankruptcy court authorization, for use by the Debtor
12 post-petition for "working capital, and general corporate purposes, administrative expenses, U.S.
13 Trustee fees, as well as any expenses approved by the Bankruptcy Court";
- 14 2. Interest on borrowed funds at Prime² plus 10% on "all outstanding obligations," payable monthly;
- 15 3. Administrative priority treatment on unpaid balances;
- 16 4. A security interest in all of the Debtor's assets, superior in priority to any prior lender's (a "priming
17 first lien");
- 18 5. Payment of \$5,000 to cover Sunstone's out-of-pocket expenses;
- 19 6. Payment of a "\$50,000 fully earned, non-refundable Work Fee upon full execution of this Term
20 Sheet."
- 21 7. A "facility fee" equal to 5% of the amount of the DIP facility payable upon final approval of the
22 facility by the court.
- 23 8. A "Breakup Fee" of \$250,000, payable in the event the loan facility was not closed due to the
24 Debtor's election to seek other financing.

24 ²The Prime rate on October 25, 2013 was 3.25%. See:
25 http://online.wsj.com/mdc/public/page/2_3020-moneyrate-20131025.html?mod=mdc_pastcalendar

1 According to the Term Sheet, the purpose of the Breakup Fee was “to induce Lender to enter into this
2 Term Sheet, to incur time and expense in participating in the negotiations contemplated herein, and to set
3 aside the funds necessary to fund the DIP loan while foregoing pursuit of other lender opportunities....” The
4 Term Sheet provided that the Lender’s commitment would remain enforceable until a final order approving
5 (other) financing was approved by the Bankruptcy Court. At that point the Breakup Fee would become due.
6 The Term Sheet acknowledges that payment “must be approved” by the Court. The Debtor undertook to
7 support Sunstone’s motion for treatment of the Breakup Fee as an administrative expense.

8 By the time the Term Sheet was signed, Debtor and Bank had in fact made substantial progress in
9 their negotiations, including establishing an interest rate at LIBOR³ + 4.5% to 5%, well below the interest
10 rate provided for in the Sunstone Term Sheet. Debtor’s management revealed to the Bank that it had signed a
11 term sheet with an alternative lender, but did not reveal the terms of the competing loan.

12 The Bank’s representatives were unimpressed. Given the progress made in their discussions with the
13 Debtor, they did not believe the Debtor had obtained better terms. Nevertheless, their response to the
14 suggestion that Debtor might go elsewhere was emphatic: unless the DIP facility was with the Bank, the DIP
15 would be required to obtain a court order subordinating the Bank’s lien to that of the new lender (“Priming”),
16 and an order allowing the DIP to use the Bank’s cash collateral, or both. The Bank made it clear that the
17 attempt would be hotly contested, at great expense to all concerned.

18 Debtor filed its Chapter 11 petition on November 19, 2013, having arrived at an agreement with the
19 Bank the day before. First day motions included a motion for approval of an order allowing financing on
20 considerably better terms than offered by Sunstone:

21 1. DIP facility: A secured revolving line of credit in an aggregate principal amount as of any day
22 equal to the lesser of (1) \$23 million; (2) the Borrowing Base plus \$12 million; or (3) certain
defined balances plus \$4 million.

23 2. Interest at LIBOR plus 4.5% to 5%.

24
25
26 ³ The LIBOR 12-month rate as of November 2013 was .5867%. See
http://www.fedprimerate.com/libor/libor_rates_history.htm.

1 3. Superpriority administrative expense treatment on all unpaid post-petition advances.

2 4. Collateral: A first-priority perfected security interest and lien in all assets of the Debtor,
3 subject to valid, perfected, prior pre-petition liens, Priming Interests and Permitted Liens as
4 described in the Bank's Financing Agreement, and a carveout of \$100,000 for US Trustee fees
5 and professional fees.

6 5. A non-refundable "Facility Fee" of \$350,000, to be reduced by 50% if a Plan of
7 Reorganization providing for payment in full of U.S. Bank's claim on the effective date of the
8 Plan is confirmed within 9 months of the bankruptcy petition date, or reduced by \$100,000 if
9 such a Plan is confirmed within one year.

10 6. Maturity Date: The date that is the earliest of: (1) one year after the bankruptcy petition date,
11 (2) upon the closing of any sale under 11 U.S.C. § 363 that is of substantially all of Debtor's
12 assets, or (3) upon the effective date of a confirmed Plan of Reorganization.

13 A final order approving the DIP facility was entered on December 27, 2013 [see docket #234]. The
14 terms varied from the interim order in many respects, the result of negotiations between the Unsecured
15 Creditors' Committee and the Bank. Sunstone does not appear to have been a factor in these discussions.

16 According to the Term Sheet, the Breakup Fee came due when the final order was entered. Sunstone
17 filed a proof of claim (claim #72)⁴, and a motion for an order allowing the \$250,000 claim as an
18 administrative expense under Code §503(b). The Committee, mezzanine lenders and the Bank object, both
19 to the administrative treatment and the claim itself. True to its commitment, the DIP supports Sunstone's
20 motion.

ISSUES

21 1. Does Sunstone have an allowable claim for the Breakup Fee?
22 2. If the Breakup Fee is allowable, is it entitled to administrative priority under 11 U.S.C. § 503(b)⁵?

23 // // //

24 // // //

25 ⁴ The \$50,000 Work Fee and \$5,000 in expense reimbursements were paid to Sunstone prior to the
26 petition date and are not included in Sunstone's proof of claim.

25 ⁵ Any statutory reference herein, unless specified otherwise, is in reference to the U.S. Bankruptcy
26 Code, 11 U.S.C. § 101, *et seq.*

DISCUSSION

A. Sunstone's Claim:

A proof of claim filed in accordance with the Federal Rules of Bankruptcy Procedure constitutes prima facie evidence of the validity and amount of the claim. Fed.R.Bankr.P. 3001(f). Should an objection be taken, the objector must produce evidence and show facts tending to defeat the claim by probitive force equal to that of the allegations of the proof of claim itself. *In re King St. Investments, Inc.*, 219 B.R. 848, 858 (9th Cir. BAP 1998).

To Sunstone's proof of claim is attached an explanation as to the nature of the claim and a copy of the executed agreement entitled "Term Sheet for Debtor-In-Possession Loan," dated October 25, 2013. The Term Sheet sets out an executed contract: Sunstone agreed to commit to advance funds throughout the process of arranging the DIP facility, and performed various tasks in furtherance of that commitment. Debtor promised to pay for that service, including the Breakup Fee, should the Debtor choose an alternate post-petition financing arrangement with another lender. Sunstone and the Debtor thereafter executed a "Superpriority DIP Credit Agreement" dated November 14, 2013, which incorporates the terms of the Term Sheet and contains an affirmative covenant regarding the Breakup Fee (see ¶ 4.4 of the Agreement).

The objecting parties argue that Sunstone's claim should be denied in its entirety for a number of reasons, including: (1) the Breakup Fee constitutes an avoidable fraudulent transfer under § 548(a)(1)(B)⁶, (2) a significant material term, the amount of the credit facility, is missing, (3) the Term Sheet is "vague and illusory," (4) the Breakup Fee is not in the best interest of the estate and greatly exceeds the amounts allowed in asset sale cases, as a percentage of the sale price.

The Breakup Fee, while appearing to be on the high side, was negotiated by the Debtor and Sunstone. There was unrebutted testimony that Sunstone would not have agreed to provide post-petition financing without the Breakup Fee. Consideration was given for the Debtor's agreement to pay the contingent fee in

⁶ Transfer may be avoided if the debtor received less than a reasonably equivalent value in exchange for such transfer or obligation.

1 Sunstone's willingness to become an alternate lender on short notice and to move the Debtor to the top of its
2 client list. Without evidence, the Court cannot determine whether the \$250,000 fee constituted "reasonably
3 equivalent value" for the services provided, and will not disallow the claim on that basis.⁷ No evidence was
4 presented as to what a reasonable breakup fee should be in the circumstances of this case, other than to claim
5 that it should be zero.

6 Objection is also made to the fact that the amount of the DIP facility (a material term) is provided in
7 the Term Sheet as \$5 million to \$7.5 million and that the agreement as a whole is "vague and illusory," so as
8 to render the agreement unenforceable.

9 Generally, where contracting parties have concluded a transaction in which it appears that they intend
10 to make a contract, "the court should not frustrate their intention if it is possible to reach a fair and just result,
11 even though this requires a choice among conflicting meanings and the filling of some gaps that the parties
12 have left." *Corbin on Contracts* § 4.1 (1993, Supp 2013). Where a monetary amount is left vague or
13 indefinite, the agreement will be enforceable if the parties provide a practicable method for determining the
14 price or amount. *Id.* The amount of the DIP facility was described as a range. However, because the
15 agreement was denominated a "Term Sheet," it is clear that a more formal agreement to fill in gaps will
16 follow. In fact, the Debtor and Sunstone thereafter executed their "Superpriority DIP Credit Agreement,"
17 which filled in gaps left by the Term Sheet and clarified a DIP facility of "up to \$7,000,000." The Term
18 Sheet evidenced an intent by the parties to enter into a contract, provided the basic terms of the agreement,
19 elements of default, and remedies after default.

20 The Term Sheet represents an enforceable contract subject to a condition subsequent that the
21 bankruptcy court either approve the Sunstone DIP facility (in which case Sunstone would lend Debtor up to
22 \$7 million on the terms approved by the court) or enter an order approving a DIP facility from another lender
23 (in which case the Breakup Fee would be due). The Breakup Fee is a prepetition claim against the estate. *In*
24

25 ⁷ Strictly speaking, there was no "transfer" made in this transaction as that term is defined at §
26 101(54), and thus no fraudulent transfer. What the objectors are actually alleging is that either no or
inadequate consideration was given by Sunstone for the Debtor's promise to pay the Breakup Fee.

re Wade Cook Fin. Corp., 375 B.R. 580, 595 (9th Cir. BAP 2007)(The character of a claim does not transform from prepetition to postpetition because the claim is contingent).

B. Administrative Expense Treatment

Sunstone seeks administrative expense priority under §§ 503(b)(1)(A) and (b)(3):

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –

(1)(A) the actual, necessary costs and expenses of preserving the estate including –
(i) wages, salaries, and commissions for services rendered after the

commencement of the case; and
(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board . . .

(3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph 4 of this subsection, incurred by –

1

(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title;

The burden of proving an administrative expense claim is on the claimant. *Microsoft Corp. v. DAK Industries, Inc. (In re DAK Industries, Inc.)*, 66 F.3d 1091, 1094 (9th Cir. 1995). An administrative claimant is entitled to be paid in full in cash on the effective date of the plan of reorganization. § 1129(a)(9)(A). A creditor would benefit should administrative expense treatment be allowed, as its claim would otherwise be reduced to a general unsecured claim pursuant to the terms of the Debtor's plan.

Section 503(b)(1)(A)

Under this provision, the claimant must show that the debt asserted to be an administrative expense arose from a transaction with the debtor-in-possession as opposed to the preceding entity (or, alternatively, that the claimant gave consideration to the debtor-in-possession); and (2) directly and substantially benefitted the estate.” *Id.* (citing *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987)). In order to keep administrative costs to the estate at a minimum, ‘the actual, necessary costs and expenses of managing the estate,’ [§ 503(b)(1)(A)], are construed narrowly.” *Id.* (internal citation omitted).

Sunstone argues that its pre-petition actions provided a substantial benefit to the estate, including the smooth and successful launching of the bankruptcy case,” and the benefit derived from “softened” lending

1 terms eventually provided by US Bank. Sunstone provided the Debtor with the assurances it needed to
2 prepare for and file for bankruptcy, and the confidence to communicate with vendors, knowing it had
3 alternate financing should Debtor not be successful in reaching an agreement with US Bank. Moreover,
4 Sunstone provided the Debtor with leverage in its negotiations with US Bank which resulted in the Bank
5 making concessions.

6 These alleged beneficial effects of the Debtor and Sunstone entering into the Term Sheet, however,
7 occurred pre-petition, as did the execution of the Term Sheet itself. The Term Sheet was an agreement
8 between Sunstone and the prepetition non-debtor entity C & K Market, Inc. Under the test provided by the
9 Ninth Circuit above, the claim arising from the pre-petition Term Sheet does not qualify for administrative
10 expense treatment under § 503(b)(1). Even disregarding the requirements of the *DAK* opinion, the evidence
11 presented to the Court showed that, while US Bank knew generally that the Debtor had an agreement with
12 another lender, it did not know any of the details of the Term Sheet, and that the Bank was not influenced by
13 Sunstone in its negotiations with the Debtor. In fact, by the time the Term Sheet was entered into, the Debtor
14 and the Bank had made substantial progress in their negotiations.

15 It could be argued that by holding its offer to provide post-petition lending open until the Court
16 entered a final order approving the post-petition loan facility with US Bank, Sunstone provided consideration
17 to the DIP. That may be so, but that in itself is not the “direct and substantial” benefit to the estate that would
18 transform a pre-petition contingent claim to an administrative expense claim. There is no evidence that
19 providing an alternate, if costly, loan facility should the Court not enter a final order approving the Bank
20 financing provided more than an incidental benefit to the estate. The Bank indicated a willingness to make
21 changes post-petition in order to allow entry of a final order, as evidenced by the changes it made in
22 negotiations with the Unsecured Creditors’ Committee. Any benefit provided by Sunstone, if any, was too
23 indirect and intangible to qualify for priority treatment.

24 Section 503(b)(3)

25 Sunstone argues that its actions in providing alternate post-petition financing made a “substantial
26 contribution” in the case, such that its Breakup Fee should be accorded administrative expense priority. The

1 opposition cites to *Christian Life Center Litigation Defense Comm. v. Silva (In re Christian Life Center)*, 821
2 F.2d 1370, 1373-74 (9th Cir. 1987), that “[c]laims that arise from a creditor’s pre-petition services to the
3 debtor are not entitled to administrative expense priority.” Sunstone counters that *Christian Life* is
4 distinguishable from the facts in this case.

5 Section 503(b)(3)(D) allows as an administrative expense to a creditor “the actual, necessary
6 expenses” incurred by the creditor in making a substantial contribution in a bankruptcy case. The Breakup
7 Fee is not, however, an actual expense of Sunstone – it’s not an expense at all. Sunstone’s actual
8 expenditures were repaid pre-petition. Even if the Court could find that costs associated with pre-petition
9 services by a creditor which make a substantial contribution in a later-filed bankruptcy could be accorded
10 administrative expense priority under § 503(b)(3)⁸, it would not help Sunstone in this instance.

11 CONCLUSION

12 Sunstone makes a policy argument that breakup fees should be allowed so as to encourage competing
13 bids by lenders. However, restrictive language of the Bankruptcy Code respecting administrative priority,
14 and priorities in general, reflects a Congressional policy of promoting equal distribution among creditors.
15 Moreover, restrictions on breakup fees are just as likely to promote competition and broader negotiations,
16 and less expensive credit for debtors, by encouraging lenders to submit proposals more likely to be accepted
17 by debtors, other creditors, and ultimately, bankruptcy courts.

18 Objections to Sunstone’s unsecured claim in the amount of \$250,000 will be denied as will
19 Sunstone’s motion for an administrative expense under § 503(b). The Court will enter an order to that effect.

20
21 
22

23 FRANK R. ALLEY, III
24 Chief Bankruptcy Judge

25 _____
26 ⁸ Because Sunstone is not seeking reimbursement of expenses and does not qualify for administrative
expense treatment under § 503(b)(3) on that basis, the Court does not reach the question posed by the
opposition in its citation to *Christian Life Center*.